No. 5724

In the United States Circuit Court of Appeals for the Ninth Circuit

DAVID H. BLAIR, COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

JOHN H. ROSSETER, RESPONDENT

UPON PETITION TO REVIEW AN ORDER OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR PETITIONER

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John H. Rosseter, respondent

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PREVIOUS OPINION IN THE PRESENT CASE

The only previous opinion is that of the United States Board of Tax Appeals (R. 18), which is reported in 12 B. T. A. 254.

JURISDICTION

The petition for review in this case involves income tax in the amount of $11,358.98 for the year 1920, and is taken from a decision (order of redetermination) by the United States Board of Tax Appeals entered May 31, 1928. (R. 20.) The case is brought to this court by a petition for review filed

November 15, 1928 (R. 21), pursuant to the Revenue Act of 1926, c. 27, Sections 1001, 1002, and 1003, 44 Stat. 9, 109–110.

QUESTION PRESENTED

In 1920 the Sperry Flour Company paid $50,000 to its president (respondent herein) "as evidence of the appreciation of the stockholders for the very efficient and valuable services renderd to the Company." The question is whether the money is taxable to the respondent as income derived from compensation for personal service or whether it was a gift and thus exempt from taxation.

STATUTES INVOLVED

The pertinent provisions of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1152, are as follows:

> SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—
>
> (a) Includes gains, profits, and income derived from salaries, wages, or compensation for personal service * * * or gains or profits and income derived from any source whatever. * * *
>
> (b) Does not include the following items, which shall be exempt from taxation under this title:
>
> * * * * *
>
> (3) The value of property acquired by gift * * *.

STATEMENT OF FACTS

The Commissioner determined a deficiency in income tax against the respondent in the amount of $11,358.98 for the year 1920. (R. 9.) In computing the deficiency the Commissioner included in respondent's gross income the sum of $50,000 determined to be compensation for services actually rendered, which the respondent contended was a gift and not subject to income tax.

The Board of Tax Appeals found the following facts (R. 15–18).

Respondent is a resident of California and during the years 1910 to 1922 was president of Sperry Flour Company. At the annual meeting of the stockholders of Sperry Flour Company, held August 16, 1920, a resolution, with prefatory statement, was adopted, as follows:

> Director Wm. H. Crocker addressed the stockholders and gave a very interesting *résumé* of the affairs of the Company since its reorganization in 1910. He said the marked success of the Company since that date was due to the able and successful direction of its affairs by President J. H. Rosseter, and suggested that as evidence of the appreciation of the stockholders for the very efficient and valuable services rendered to the company, that President Rosseter be voted a gift of Fifty Thousand ($50,000) Dollars.
>
> Thereupon, on motion of D. B. Moody, seconded by Charlotte E. Sperry, the stock-

> holders by an unanimous vote instructed the Board of Directors to authorize the payment of Fifty Thousand ($50,000) Dollars as a gift to John H. Rosseter in recognition of his able and successful direction of the affairs of the Company during the past ten years.
>
> Upon motion duly made and seconded Vice-President McNear appointed W. H. Orrick and Austin Sperry a committee to draw up a letter of congratulation to accompany the gift.

Pursuant to the authorization, the board of directors on the same date passed the following resolution:

> WHEREAS at the annual meeting of the stockholders of Sperry Flour Company held on this 16th day of August, 1920, it was unanimously resolved that a gift in the sum of Fifty Thousand (50,000) Dollars be made by said Sperry Flour Company to J. H. Rosseter, the president of said Company, in recognition of his able and successful direction of its affairs during the past ten years.
>
> *Resolved,* That this Board of Directors approve the action so taken by the stockholders of said company at said meeting, and hereby directs the payment of the sum aforesaid to the said J. H. Rosseter in accordance with the said resolution.
>
> *Resolved further,* That this Board of Directors tenders *it* congratulations to the said J. H. Rosseter upon this the tenth anniversary of his election to the presidency of said Company, and its appreciation of his able

and successful direction of its affairs during the occupancy of said office.

The sum of $50,000 was paid to respondent on August 17, 1920, and on the books of the corporation the item was charged to the surplus account. In the tax return of the corporation the sum was not claimed as an expense deduction but appeared in its reconciliation of the change in surplus as "bonus to J. H. Rosseter." Respondent received from the Sperry Flour Company during each of the years he served as president the sum of $6,000, which was the full compensation provided for by his contract of employment. He devoted approximately one-fourth of his time to the interests of this company.

During part of the time between 1910 and 1922 and while respondent was president of Sperry Flour Company he was also director and Pacific Coast manager for W. R. Grace Company and vice president and general manager of the Pacific Mail Steamship Company. During part of 1918 and most of 1919 respondent was director of operations of the U. S. Shipping Board and a trustee of the Emergency Fleet Corporation. He was absent from California for long periods of time and during such absence devoted only slight attention to the affairs of Sperry Flour Company. During respondent's service as president the operations of the company were profitable and its profits were greatly increased.

Upon the foregoing findings, the Board determined that the Commissioner was in error in adding the $50,000 to respondent's income. (R. 19.)

SPECIFICATION OF ERRORS

1. The Board of Tax Appeals erred in not approving the deficiency determined by the Commissioner.

2. The Board of Tax Appeals erred in holding that the payment to the taxpayer was a gift.

3. The Board of Tax Appeals erred in not holding that the payment of $50,000 to the taxpayer in the year 1920 was taxable income to him in that year.

SUMMARY OF ARGUMENT

Congress has sought to tax all compensation for services and the payment of a bonus by a corporation to its president in recognition of his services can not be classified as a gift exempt from taxation.

The Government is not bound by the fact that the parties called the payment a gift. The relationship of the parties implies a consideration. Respondent was president of a successful corporation over a twelve-year period. His salary during each of those years remained the same and the payment of $50,000 to him during the tenth year as an evidence of appreciation of his services is entirely inconsistent with the statement that it was a gift.

Since he is claiming an exemption, respondent carries the burden of showing affirmatively that his case comes squarely within the statutory provision. The circumstances indicate that the money was paid

as compensation for personal services and any doubt must be resolved against the exemption.

ARGUMENT

THE PAYMENT TO RESPONDENT WAS NOT A GIFT, BUT WAS COMPENSATION FOR PERSONAL SERVICES

Section 213 (a) of the Revenue Act of 1918 provides that gross income shall include gains, profits, and income derived from salaries, wages, or compensation for personal service of whatever kind and in whatever form paid. Section 213 (a) (3) further provides that the value of property acquired by gift shall not be included in gross income. The question is whether the $50,000 paid to respondent as president of the Sperry Flour Company was compensation for personal services and thus taxable income under Section 213 (a) or whether the payment was a gift and thus exempt from taxation under the provisions of Section 213 (a) (3). While it is undoubtedly the law that a payment in consideration of personal services can not be a gift, we think it is further evident from the statute that a gift exempt from taxation can have no relation whatever to personal services. Congress has sought to tax all compensation for services and the payment of a bonus by a corporation to its president in recognition of his services can not be classified as a gift exempt from taxation.

Respondent was the president of the Sperry Flour Company from 1910 to 1922. The operations of the company were profitable during this time and its profits were greatly increased. Not-

withstanding this fact the salary of respondent remained constant for twelve years. During each year he received $6,000. In 1920 the stockholders of the Sperry Flour Company held a meeting which was addressed by one of the directors. He reviewed the affairs of the company since 1910 and said "the marked success of the Company since that date was due to the able and successful direction of its affairs by President J. H. Rosseter, and suggested that *as evidence of the appreciation of the stockholders for the very efficient and valuable services rendered to the company*, that President Rosseter be voted a gift of Fifty Thousand (50,000) Dollars." (Italics supplied.) Thereupon the stockholders by unanimous vote instructed the Board of Directors to authorize the payment of $50,000 to the respondent, "*in recognition of his able and successful direction of the affairs of the Company during the past ten years.*" (Italics supplied.)

To be sure, the payment was denominated as a gift, but it is submitted that calling it a gift does not make it such. In *Becker Bros.* v. *United States* (C. C. A., 2d), 7 F. (2d) 3, 6, it was said: "The government is not bound or concluded either by any resolution which the corporation adopts, or by its method of keeping its books, upon the question as to whether any particular payment is a salary payment or a division of surplus." See also *Botany Mills* v. *United States,* 278 U. S. 282, 292. We submit that the statement in the resolution of the Board

of Directors in the instant case denominating the payment to the respondent as a gift is no more binding. It is clear that the payment was made in consideration of the valuable services performed by the respondent and that it was due entirely to his official connection with the company and the highly satisfactory manner in which he had directed its affairs. The payment was made to him in his capacity as president of the corporation and would not have been paid to him at all except for "the very efficient and valuable services rendered to the company." The relationship of the parties and the expressed motive for the payment clearly negative a gratuity.

It is fundamental that there can be no gift where there is consideration. *Noel* v. *Parrott,* 15 F. (2d) 669; *Appeal of Estate of David R. Daly,* 3 B. T. A. 1042; *Cora B. Beatty, Executrix,* v. *Commissioner,* 7 B. T. A. 726.

Section 1146 of the Civil Code of California defines a gift as follows: "A gift is a transfer of personal property, made voluntarily, and without consideration." Where there is an element of consideration there can be no gift. But, further, when Congress lays a tax on compensation for services, there can be no tax-exempt gift as appreciation for services.

In *Noel* v. *Parrott, supra,* the taxpayer, upon the sale of the stock of the company to another company and as part of that transaction received $35,-000 through a " gratuitous appropriation." Be-

cause the payment was found to be in consideration for the prior services of the taxpayer and the relinquishment of his position, and because the payment did not proceed from the generosity of the giver, it was held that the payment of the money was not a gift. Certiorari was denied. (273 U. S. 754.) While the corporation in that case claimed a deduction for the amount so paid to the taxpayer, it is evident that the question of whether the amount is properly deductible as an expense by the corporation has no relation to the question of whether the same amount is taxable income to the recipient. An excessive payment may be denied as a deduction because it is unreasonable, but since the element of reasonableness does not affect the question of income to the recipient, the payment may at the same time be taxable income to him. *United States* v. *Snook,* 24 F. (2d) 844.

In *Cora B. Beatty, Executrix,* v. *Commissioner, supra,* the trustees of the Carnegie Institute retired Beatty from active service "and as a recognition of his valued and honored labors" appointed him Director Emeritus of the Department of Fine Arts upon an "honorarium" of $500 a month. Thereafter he had no assignment of duties and performed no service of any kind. It was contended that the honorarium was a tax-exempt gift, but the Board held that the payments constituted taxable income.

We contend that there can be no gift where the relationship of the parties implies a consideration, even though it may be treated as a gift by the par-

ties themselves. It is clear that a distribution by a corporation to its stockholders, even though described as a gift, would nevertheless constitute a dividend, for the reason that the mere relationship of the parties compels the implication that the payment is a distribution of profits.

The president and guiding genius of a successful corporation would ordinarily be rewarded by an increase in his annual salary. The respondent was the president of the corporation for a period of twelve years and the Board found as a fact that during his services as president the operations of the company were profitable and its profits were greatly increased. (R. 18.) Yet during each of those years he received the same salary. Instead of pursuing the normal course and increasing the respondent's annual compensation, the corporation determined to pay him a lump sum of $50,000 "as evidence of the appreciation of the stockholders for the very efficient and valuable services rendered to the company." (R. 16.) The amount was charged to the surplus account of the corporation and appeared in its tax return as "bonus to J. H. Rosseter." (R. 17.) A bonus was a familiar form of salary increase in 1920 and is not a gift. *Noel* v. *Parrott, supra.*

It is a matter of general knowledge that corporations have found it profitable to reward efficient services by subsequent bonuses. Such a payment is made not only in order to deal fairly with the employee, but in so far as it is conducive to greater

effort in the future, the corporation receives something for it. In no sense is such a bonus occasioned by pure generosity. The very object of a mercantile corporation is a denial of such a motive and the frequency with which such corporations make bonuses is indicative of their purpose in so doing. In *Noel* v. *Parrott, supra,* the absence of such a motive was treated as significant.

The Board of Tax Appeals attached much weight to the declaration in the resolution that the payment was a gift. However, as shown above, the United States is not bound by any such statement when there is an inconsistency between it and the surrounding circumstances. A corporation which pays its president a lump sum of $50,000 in recognition of his services and at the same time maintains his salary at a constant figure over a twelve-year period can not by a mere declaration that it is a gift convert what would otherwise be taxable income into an exempt gratuity. No element of sentiment entered into this payment. The corporation was rewarding its president because he had served it well in that capacity. Taxation is a practical matter and the Government is bound to look through the form of the transaction and ascertain the actualities.

The Board cited *Appeal of Estate of David R. Daly, supra,* as a precedent for its conclusion in the instant case. In that case a corporation passed resolutions voting gifts in named amounts, with no allusion to the services rendered by the recipients.

No surrounding circumstances were disclosed to negative the description of the payments as gifts and they were held to be tax-exempt. Since the recipient was an officer of the corporation, however, it is submitted that the Board's acceptance of the mere declaration of the resolutions was ill-advised and opens the door for tax evasion. The minority opinion in the instant case properly connects the payment to respondent with services rendered by him, which is sufficient to classify it as taxable income.

The Board was also influenced by the fact that the corporation did not treat the payment as an expense and claim it as a deduction in its corporate return. We submit that no significance can be attached to that circumstance for the reason that a payment to an officer in a single year of an amount more than eight times his annual salary would undoubtedly have been challenged as unreasonable and the deduction would have been denied. But a controversy between the corporation and the United States with respect to whether the payment was reasonable could have no bearing upon the duty of the employee to report it as income to him. *United States* v. *Snook, supra.*

The respondent is here claiming an exemption and it is settled that the burden falls upon him in such a matter to show affirmatively that his case comes squarely within the statutory provision. *Theological Seminary* v. *Illinois,* 188 U. S. 662; *Metropolitan Street Ry. Co.* v. *New York,* 199 U.

S. 1, 35; *Botany Mills* v. *United States, supra.* A well-founded doubt is fatal to the claim. *Bank of Commerce* v. *Tennessee,* 161 U. S. 134.

When it is remembered that the determination of the Commissioner is *prima facie* correct; that the statement of the Board of Directors that the payment was a gift does not conclude the United States, and that an attempt of the corporation to claim the payment as a deduction would have been challenged, we submit that the respondent failed to bear the burden cast upon him and that the Board of Tax Appeals placed an erroneous interpretation upon the whole transaction. There is sufficient doubt about this transaction to justify the imposition of the tax.

CONCLUSION

In view of the foregoing, it is respectfully submitted that the decision of the Board of Tax Appeals should be reversed.

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